

TEACHERS' RETIREMENT BOARD  
SUBCOMMITTEE ON CORPORATE GOVERNANCE

---

SUBJECT: Homeland Security Discussions

ITEM NUMBER: 4

ATTACHMENT(S): 2

ACTION: \_\_\_\_\_

DATE OF MEETING: October 2, 2002

INFORMATION: X

PRESENTER(S): Janice Hester Amey

---

**Executive Summary**

The Chair of the Subcommittee on Corporate Governance, State Treasurer Phil Angelides has directed staff to present an information item on the companies that may prove to be of concern in this regard. The list of these companies, known as the Global Security Risk Monitor (GSRM), is produced as a joint venture between the Investor Research and Responsibility Center (IRRC) and the Conflict Securities Advisory Group (CSAG).

CalSTRS has used IRRC products for over two decades and has great respect for its research products; as you may remember, IRRC does not advise on issues, it only provides research on issues that investors are concerned about. CSAG is a Washington, D.C. firm that apparently specializes in identifying and assessing global risk factors in the U.S. and other capital markets. In checking with other public pension funds, staff was only able to identify one other client for the service, CalPERS. CalSTRS has signed a contract for delivery of the service at the cost of \$12,500.00 per year. Staff intends to have a joint meeting with IRRC and CSAG on Monday, September 16, 2002 to address its concerns regarding methodology, magnitude, validation, and credibility. Information gleaned from that meeting will be provided at the Subcommittee Meeting.

Staff has learned that companies get placed on the GSRM list if they have proliferation-related concerns and/or a tie to a country that sponsors terrorism. Companies are then examined for a "Country Link." Country links are measured by a company's equity tie, non-equity tie, or "other" tie to one of the six indicated countries: IRAQ, IRAN, SUDAN, SYRIA, LIBYA AND NORTH KOREA.

Definitions of the criteria are listed below:

**Proliferation Link**

Proliferation can be divided into two types of activity, with some overlap between them. First, proliferation concerns arise from the illicit trade of completed weapons systems, components and materials that are intended for military use. Second, international trade in "dual-use" technologies,

equipment and expertise (i.e., items that can have both civilian and military applications) can end up making available the ingredients to advance weapons of mass destruction and ballistic missile programs. The former activity usually provides a clearer target for efforts to curtail proliferation, as it involves the sale of goods and technologies that are originally designed or built for military application. North Korea's sales of missile technology to Iran, for example, have provided that government with an increasingly self-sufficient missile program and enhanced the country's power projection capabilities.

### **Country Link**

Country links are measured by a company's equity tie, non-equity tie, or other tie to one of the six specified countries. The terms are defined as follows:

- Equity Tie: Company or subsidiary has employees or facilities physically located in the country.
- Non-Equity Tie: Company or subsidiary sells products or services in the country, purchases goods or raw materials from the country, or has distribution agreements with another party for the company's products in the country.
- Other Tie: Company ties that do not appear to meet the definition of either an equity or non-equity tie. An example—the company sponsored a booth at a trade show in the country.

Based on the depth of a company's country and/or proliferation tie, CSAG assigns the company a **risk** level, and provides detailed support within the individual company reports:

- Compounded Risk: Potential for more pronounced financial or reputational impact upon share value, due to corporate exposure to Security Risks in two or more venues (i.e., countries or sectors covered by GSRM).
- Reputational Risk: Potential for a negative impact on a corporation's overall reputation that may, in turn, cause downward pressure on that corporation's share value.
- Insufficient Information: There is not enough information available to determine whether or not a company's operations represent a Security Risk to investors.

### **Materiality**

Each company within the GSRM has an individual profile. In each company's profile, there is a "Revenue and Financials" section. This section provides data on the financial implications for the company, and when available for the governments, related to its operations in the countries tracked by GSRM. However, GSRM does not measure the dollar activity materiality (i.e., Iran sales as % of revenue, or % of earnings, etc.).

- *Exclusions:* Company A operates in one of the six specified countries. If Company B owns less than 10% interest in Company A, Company B will not be included in GSRM.

Each company is given an individual profile that includes a revenue and financials section. This section is designed to provide data on the financial implications for the company and/or governments related to the companies' operations in the six countries. Seemingly, this step would go toward the issue of materiality for each company and investor.

Attachment 1 presents the GSRM list as of July 19, 2002. The next list is expected to be provided on September 19, 2002. If available we will bring copies of it to the meeting for your perusal. Attachment II is a sample report on a specific company, Royal Dutch.

As noted on the list of compound exposure, the top 7 names in the CalSTRS portfolio comprise almost 90% of the exposure. These companies are large multinational firms such as the oil companies of Royal Dutch, Total Fina, Conoco, and insurance/financial firms title ING, BNB Paribas Bank, and the industrial electronics giant Siemens. Measuring the exposure level of materiality within these firms is critical to developing an assessment of the risk to CalSTRS and the appropriate plan of action.

**Corporate Global Security Risk Monitor Profile**

Profile Printed: September 18th, 2002

**SIEMENS A G**

TICKER: SI

CUSIP: 826197

SEDOL: 2742689

ISIN: US8261975010

**Capsule****Country Link Snapshot**

|             | Equity Tie | Non-Equity Tie | Other Tie | No Tie |
|-------------|------------|----------------|-----------|--------|
| Iran        | ✓          |                |           |        |
| Iraq        |            |                |           | ✓      |
| Libya       |            |                |           | ✓      |
| North Korea |            |                |           | ✓      |
| Sudan       | ✓          |                |           |        |
| Syria       |            | ✓              |           |        |

**CSAG Security Snapshot**

| Compounded Risk | Risk | No Risk | Insufficient Information |
|-----------------|------|---------|--------------------------|
| ✓               |      |         |                          |

**Ethics Snapshot**

| Global Sullivan Principles | Other External Code | Other Internal Code |
|----------------------------|---------------------|---------------------|
| No                         | Yes                 | Yes                 |

**Country Details****Iran***Overview of Operations*

Siemens AG has a number of Iranian subsidiaries, including the following: Sherkate Tarhaye Siemens, Tehran (100 percent equity stake); Siemens Sherkate Sahami (Kass), Tehran (97 percent); Iranian Lamps Ltd., Tehran (25 percent); Iranian Telecommunications Manufacturing Co., Shiraz (20 percent); ITS Tehran, Tehran (48 percent); OSRAM Iran Ltd., Tehran (49 percent).

Siemens has 65 4,130 megawatt turbine units in Iran. (Middle East Economic Digest (MEED), Weekly Special Report: Germany: Siemens, 12/7/2001)

Siemens is involved in the upgrade of both the local mobile and fixed telephone networks in Iran. In addition, Siemens is a 20 percent shareholder in the Shiraz-

based Iranian Telecommunication and Manufacturing Co. (ITMC), which manufactures digital telephone exchanges. The company noted in 2001 that the tender for a second mobile phone license is expected in 2002. (MEED, 12/7/2001)

Siemens holds 16.8 percent interest in AO Electrosila, the top Russian maker of power station generators. Electrosila is involved in the controversial Bushehr nuclear power plant in Iran. (See Iran country overview.) (Bloomberg News, 11/21/2001) Completion of the project is delayed by at least two years. (Agence France Presse, 4/16/2001) Siemens pulled out of a contract to supply the project with auxiliary equipment at the request of the German government. The German government aims to phase out nuclear power over the next 20 years. (Nuclear Engineering International, 3/31/01)

Voith Siemens, a Siemens joint venture with JM Voith, is part of a consortium led by Holzmann AG that received contract from the Iran Water and Power Development Corp. to build a water-power plant on the Bakhtiary river in Iran. (AFX European Focus, 11/27/2000)

Siemens Austria has a contract with an Iranian company, Wagon Pars, for 20 diesel trainsets. (MEED, 10/27/2000)

#### *Revenue and Financials*

Under the original contract for the Bushehr nuclear power plant, the reactor's construction will infuse US \$800 million to a \$1 billion into the Russian economy. The Bakhtiary river waste-power plant consortium project was valued at US \$437 million. Financial information about the company's other operations in Iran was not available, nor was information on revenues that the government of Iran receives from these operations.

#### *Points of Interest*

IRRC and CSAG did not discover evidence of any lawsuits, shareholder activism, divestment campaigns or other notable events associated with the company's operations in Iran.

### **Sudan**

#### *Overview of Operations*

Siemens has an office in Khartoum, Sudan. (Company Website, 2/2002)

A consortium headed by the Siemens Industrial Solutions and Services Group (I&S) has been awarded a contract to erect a turnkey diesel power station with an output of 257 megawatts in Khartoum. It will be the world's largest power station powered by diesel engines. Commissioning of the power station is to take place in stages in 2004. (Company Website, 2/2002)

The Sudanese Telecommunications Co. (Sudatel) contracted with Siemens to supply 23,000 advanced digital lines to expand networks and integrated digital services in Sudan. (BBC Monitoring Middle East - Economic, 8/1999)

#### *Revenue and Financials*

The company's turnkey diesel power station contract is valued at more than US

\$175 million. Siemens gets half. Its digital line contract was valued at US \$2.7 million. Financial information about revenues that the government of Sudan receives from these operations was not available.

#### *Points of Interest*

IRRC and CSAG did not discover evidence of any lawsuits, shareholder activism, divestment campaigns or other notable events associated with the company's operations in Sudan.

## **Syria**

#### *Overview of Operations*

Siemens' has a global purchasing contract with Egypt's Orascom Telecom for construction of GSM (Global System for Mobile Communication) wireless systems. Orascom has a license to provide wireless telecom to 750,000 subscribers in Syria. Orascom set up a trial system in Syria in February 2000 with the assistance of Siemens, and was awarded a contract by the Syrian Telecommunications Enterprise in 2001. (Financial Times, 4/1/2001; Gulf News, 8/14/2001)

#### *Revenue and Financials*

Financial information about the company's operations in Syria was not available, nor was information on revenues that the government of Syria receives from these operations.

#### *Points of Interest*

IRRC and CSAG did not discover evidence of any lawsuits, shareholder activism, divestment campaigns or other notable events associated with the company's operations in Syria.

## **CSAG Security Overview**

Siemens AG and its subsidiaries have operations in the energy, telecommunications and manufacturing sectors of Iran. The company also has operations in Sudan's energy and telecommunications sectors as well as Syria's telecommunications sector. Due to the company's scope and type of involvement in these sectors, financial or reputational risks exist with respect to global security concerns that merit investor attention. These risks are compounded by Siemens AG's operations in more than one country and sector reviewed by the Monitor.

---

The energy sector has potential security risks including the following:

- Activities in this sector can generate significant hard currency revenues, particularly from energy exports, that are available for discretionary use by the government;
- Certain types of power generation facilities and related components have potential military applications;
- The governments covered by the Monitor often rely on foreign firms for advanced technologies, equipment, industry expertise and financing for large-scale energy projects; and
- These governments and their state-owned entities or agencies are closely linked to the commercial energy sector.

The telecommunications sector has potential security risks including the following:

- Certain telecommunications equipment and technologies have potential military (or 'dual use') applications;
- Certain types of telecommunications infrastructure, such as command and control technology, computers, communications and intelligence systems, are central to military capabilities;
- The governments covered by the Monitor, and their state-owned entities or agencies, are closely linked to the commercial telecommunications sector; and
- These governments often rely on foreign firms for advanced telecommunications technologies, equipment, industry expertise and financing for large-scale projects.

The manufacturing sector has potential security risks including the following:

- Certain equipment and technologies in the manufacturing sector have potential military (or 'dual use') applications;
- Certain chemical, pharmaceutical and other manufacturing facilities can house militarily relevant projects ;
- The governments covered by the Monitor, and their state-owned entities or agencies, are closely linked to the commercial manufacturing sector; and
- These governments and their state-owned entities or agencies often rely on foreign firms for advanced manufacturing, chemical and pharmaceutical technologies, equipment, industry expertise and financing for large-scale projects.

## **Company Code of Conduct/Ethics Policies**

Siemens has a seven point set of Corporate Principles adopted in 1997, including the following section under Corporate Citizenship: " Integrity guides our conduct toward our business partners, colleagues, shareholders, and the general public. Cultural differences enrich our organization." (Company Website, 2002)

The company also has a binding set of Business Conduct Guidelines for all employees worldwide. The 2001 Corporate Citizenship Report refers to these guidelines saying, "These rules are intended to help ensure fair and corruption-free competition." In the same document, the company also refers to Organization for Economic Cooperation and Development guidelines for multinational enterprises as "important principles that govern the way [Siemens] does business all over the world.

## **Company Response**

The company did not respond to IRRC and CSAG's questionnaire within the deadline set by IRRC and CSAG.

---

## **Links to Proliferation-Related Concerns**

According to a Daily Telegraph article of Dec. 7, 1999, the New Yorker Magazine reported earlier that month that Siemens had been "duped" by the Iraqi regime into providing 120 "special electronic switches" intended for medical machinery that the Iraqi regime reportedly intends for use as trigger switches in nuclear weapons. The Daily Telegraph reported that approximately 32 switches of this type are required per nuclear warhead. It was further reported that Siemens' supply of over 100 could have contributed enough switches for three warheads. (Daily Telegraph, 12/7/99)

The Siemens switches were reportedly part of six lithotripters, which are medical devices used to destroy kidney stones with high-powered shockwaves. (The Times (London), 10/29/01)

### **Citations**

"Saddam Must Go." Daniel Finkelstein. The Times (London). 10/29/01.; "Saddam's Nuclear Bomb." Michael Cameron. The Daily Telegraph. 12/7/99.; "Department of Mass Destruction: Saddam's Nuclear Shopping Spree." Gary Milhollin. The New Yorker. 12/13/99.

### **Company Response**

The company did not respond to IRRC and CSAG's questionnaire within the deadline set by IRRC and CSAG.

Please see Product Overview for important disclaimer information.

---

© IRRC and CSAG 2002. All Rights Reserved. It is unlawful to copy, distribute or otherwise reproduce these materials without the express written permission of IRRC and CSAG.